

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 02-33778

JACK R. SNOW
d/b/a THE COPY CENTER
d/b/a AMERICAN BUSINESS SYSTEMS
f/d/b/a THE MOVIE STATION
VIVIAN S. SNOW
d/b/a THE COPY CENTER
d/b/a AMERICAN BUSINESS SYSTEMS
f/d/b/a THE MOVIE STATION

Debtors

**MEMORANDUM ON CONFIRMATION OF
DEBTORS' FIFTH AMENDED PLAN OF REORGANIZATION**

APPEARANCES: JENKINS & JENKINS, PLLC
Edward J. Shultz, Esq.
800 South Gay Street, Suite 2121
Knoxville, Tennessee 37929-2121
Attorneys for Debtors

SHARON FRANKENBERG, ESQ.
Post Office Box 31585
Knoxville, Tennessee 37930-1585
WILSON & ASSOCIATES, P.L.L.C.
Cade L. Cox, Esq.
1521 Merrill Drive, Suite D-220
Little Rock, Arkansas 72211
Attorneys for Chase Manhattan Mortgage Corporation

RICHARD F. CLIPPARD, ESQ.
UNITED STATES TRUSTEE
Patricia C. Foster, Esq.
800 Market Street, Suite 114
Knoxville, Tennessee 37902
Attorneys for United States Trustee

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

Before the court is the confirmation of the Fifth Amended Plan of Reorganization filed by the Debtors on February 6, 2004 (Fifth Amended Plan). Chase Manhattan Mortgage Corporation (Chase) filed an Objection to Fourth Amended Plan of Reorganization (Objection) on December 31, 2003, which remains applicable to the Fifth Amended Plan. Chase's Objection is based upon the Debtors' proposal to pay its claim, secured only by a security interest in the Debtors' residence, under terms other than those within the parties' original contract.

An evidentiary hearing scheduled for March 30, 2004, was stricken upon the parties' announcement that there were no disputed facts and that all matters in controversy would be submitted to the court on stipulations and briefs. Accordingly, the record before the court consists of the parties' Joint Stipulations and four exhibits stipulated into evidence.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(L) (West 1993).

I

The Debtors filed the Voluntary Petition commencing their bankruptcy case under Chapter 11 on July 19, 2002, and since that date, they have operated as debtors-in-possession. Chase holds a security interest in the Debtors' residence located at 106 Clinchcrest Drive, Kingston, Tennessee (Real Property), by virtue of a Note in the principal amount of \$135,000.00 executed in favor of Barclays American/Mortgage Corporation on

October 4, 1991, that is secured by a Deed of Trust also dated October 4, 1991.¹ The maturity date of the Note is November 1, 2006. As of January 31, 2004, the payoff balance owed to Chase was \$79,984.73.²

On November 20, 2003, the Debtors filed their Fourth Amended Plan of Reorganization, proposing to pay Chase's claim as follows:

CLASS 4.1 - This class consists of the claim of Chase Manhattan Mortgage Corp. This claim, in the amount of \$72,907.74 as of April 16, 2003, is fully secured by the Debtors' residence. The claim will be paid in full over approximately 42 months, at the contract rate of interest, 8.5% by monthly payments of \$2,013.00 until paid in full including attorney's fees. The Debtors shall pay expenses of property taxes and insurance directly and such expenses are not included in this Class's plan payment. This class is impaired.

Also on November 20, 2003, the Debtors filed their Fourth Amended Disclosure Statement, which was found to be adequate and was approved by Order Approving Disclosure Statement, As Amended, Fixing Time for Filing Acceptances or Rejections of Plan, Fixing Time for Filing Objections to Confirmation, and Fixing Date for Hearing on Confirmation, Combined With Notice Thereof entered on December 1, 2003.

On December 10, 2003, the Debtors served their Fourth Amended Plan, the approved Fourth Amended Disclosure Statement, the court's December 1, 2003 Order, and a ballot upon all creditors of the Debtors. The Internal Revenue Service filed an objection to the Fourth Amended Plan on December 5, 2003, and Chase filed its Objection on December 31,

¹ The Note and Deed of Trust were assigned to Chemical Mortgage Company, a/k/a Chase, in 1992.

² The stipulated value of the Real Property is \$321,000.00. The Real Property is further encumbered by a second mortgage in the amount of \$222,000.00 held by Citizens National Bank and tax liens of the Internal Revenue Service in the amount of \$67,423.29.

2003. On January 12, 2004, the Debtors filed a Ballot Summary, stating that they had received no ballots from Classes 1, 2, 3.1, 3.2, 3.3, or 4.1, that Class 4.2 had accepted the Fourth Amended Plan, and that in Class 5, three members had accepted the plan, while one had rejected it.

Thereafter, on February 5, 2004, the Debtors filed a Motion to Extend Time to File Amended Plan, stating that they would be filing an amended plan to cure the objections filed by the Internal Revenue Service and Chase. This motion was granted, and the Debtors filed their Fifth Amended Plan of Reorganization (Fifth Amended Plan) on February 6, 2004. The Fifth Amended Plan provides for payment of Chase's claim as follows:

CLASS 4.1 - This class consists of the claim of Chase Manhattan Mortgage Corp. This claim, in the amount of \$79,984.73 as of January 29, 2004, is fully secured by the Debtors' residence. The claim will be paid in full over approximately 30 months, at the contract rate of interest, 8.5% by monthly payments of approximately \$2,968.86 until paid in full including attorney's fees. The Debtors shall pay expenses of property taxes and insurance directly and such expenses are not included in this Class's plan payment. This class is impaired.

At the hearing on confirmation held on March 4, 2004, Chase renewed its Objection as to the Fifth Amended Plan. Although the Internal Revenue Service's objection was cured by the Fifth Amended Plan, Chase's Objection remains.

Pursuant to the Joint Statement of Issues for Confirmation filed by the parties on March 24, 2004, and as reiterated at the March 30, 2004 hearing, the sole issue before the court is whether 11 U.S.C.A. § 1123(b)(5) (West 1993 & Supp. 2004) prohibits the Debtors from curing a default on a debt secured solely by their principal residence. The Debtors

argue that because they have proposed to pay Chase's claim in full, at the contract rate of interest, within the term of the original Note, their proposed treatment of the claim is permitted. In opposition, Chase argues that the Debtors' proposed treatment of its claim modifies the original terms of the Note by changing the monthly payment from \$1,329.40 to \$2,968.86, by failing to provide for an escrow of property taxes and homeowners insurance, and by extending the maturity date beyond the original November 1, 2006 maturity date.

II

Confirmation of a Chapter 11 plan is governed by 11 U.S.C.A. § 1129 (West 1993 & Supp. 2004), which provides that the court shall confirm the plan if certain requirements are met, including compliance with other provisions of Chapter 11. See 11 U.S.C.A. § 1129(a)(1). Each plan must contain certain mandatory provisions. 11 U.S.C.A. § 1123 (West 1993 & Supp. 2004). Additionally, a debtor may propose varied treatment for creditors under § 1123(b), including but not limited to allowing a debtor to:

(b)(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims[.]

11 U.S.C.A. § 1123(b)(5).

Section 1123(b)(5) was added through the Bankruptcy Reform Act of 1994 "to create a[n] exception to lien stripping under [11 U.S.C.A.] § 506(a) for chapter 11 home mortgage

lenders.”³ *Lee v. Home Sav. of Am. (In re Lee)*, 215 B.R. 22, 24 (B.A.P. 9th Cir. 1997). The primary purpose for § 1123(b)(5) is to prevent debtors in Chapter 11 from attempting to bifurcate or “cram down” mortgage debts in order to “strip off” any unsecured portion. See *In re Dailey*, 289 B.R. 707, 709 (Bankr. C.D. Ill. 2003); *In re Canonigo*, 276 B.R. 257, 264 n.11 (Bankr. N.D. Cal. 2002); *Granite Bank v. Cohen (In re Cohen)*, 267 B.R. 39, 42 (Bankr. D.N.H. 2001); *In re Leedy*, 230 B.R. 678, 681 n. 8 (Bankr. E.D. Va. 1999).

Also unique to Chapter 11 is the ability of debtors to impair a class of creditors. The authority for this action is found in 11 U.S.C.A. § 1124 (West 1993 & Supp. 2004), which provides, in material part, that a claim or interest is impaired unless the plan “leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest.” 11 U.S.C.A. § 1124(1). On the other hand, “[w]here a Chapter 11 plan provides for the cure of a default, reinstatement of the original terms of the loan, compensation for damages, and does not otherwise alter the rights of the mortgagee, the claim . . . is unimpaired.” *In re Lennington*, 288 B.R. 802, 804 (Bankr. C.D. Ill. 2003); see also 11 U.S.C.A. § 1124(2).

The Debtors’ Fifth Amended Plan states that Chase is an impaired class because the Debtors have proposed to pay the pre-petition arrearage owed to Chase in combination with their regular monthly payments owed to Chase. Accordingly, rather than pay the regular monthly mortgage payment of \$1,329.40, the Debtors propose to pay Chase \$2,968.86 per

³ Subsection (b)(5) is identical to 11 U.S.C.A. § 1322(b)(2) (West 1993) concerning Chapter 13 plans.

month. The Debtors argue that they could have proposed to make separate monthly payments, clearly denoted as arrearage payments, as if they were in a Chapter 13 plan; however, because their current proposal achieves the same result, it is not a prohibited modification.

Chase argues that because Chapter 11 does not have a similar provision to 11 U.S.C.A. § 1322(c)(2) (West 1993 & Supp. 2004), the Debtors may not cure their pre-petition arrearage as proposed because it would fall outside the original maturity date of the Note. In support of its argument, Chase relies upon the decision of *In re Clay*, 204 B.R. 786 (Bankr. N.D. Ala. 1996). In *Clay*, the court addressed the narrow issue of “whether a Chapter 11 debtor may cure the default of a balloon-type mortgage payment through a Chapter 11 plan.” *Clay*, 204 B.R. at 787. The *Clay* court found it noteworthy that Chapter 11 did not contain a provision similar to § 1322(c)(2), stating that

[w]hen Congress added [§] 1322(c)(2) as an exception to [§] 1322(b)(2) it allowed for the curing of defaults in balloon-type mortgage payments in Chapter 13 cases. When Congress added [§] 1323(b)(5) to Chapter 11, Congress added the *language* of [§] 1322(b)(2) but did not include the *excepting language* of [§] 1322(c)(2); consequently, Chapter 11 became restrictive where it was not and Chapter 13 became more permissive where it had not been.

Clay, 204 B.R. at 789.

In contrast, the Debtors rely upon the *Lennington* decision, in which the court allowed Chapter 11 debtors to cure their pre-petition mortgage arrearage by making installment

payments through their plan, as long as their post-petition payments remained current as well. *See Lennington*, 288 B.R. at 806. In support of its decision, the court held that

[p]rohibiting a debtor proceeding under Chapter 11 from curing a pre[-]petition mortgage default in installment payments, while a similarly situated debtor proceeding under Chapter 13 is permitted to do so, would be contrary to the intent of Congress to conform the treatment of residential mortgages under Chapter 11 to that under Chapter 13.

Lennington, 288 B.R. at 806. In *Lennington*, the mortgage holder relied on the failure of Congress to include in Chapter 11 a provision similar to 11 U.S.C.A. § 1322(b)(5) (West 1993), which allows Chapter 13 debtors to cure pre-petition arrearage in installment payments over the life of their plans, as evidence of its intent to disallow such payments in Chapter 11. In response to this argument, the *Lennington* court held:

It is true that this exact language is not to be found in Chapter 11. Given the very different purposes of Chapter 11 and Chapter 13, however, not much can be made of that dissimilarity. Unlike Chapters 12 and 13, the provisions of Chapter 11 and Chapter 13 are not at all parallel. . . . [R]eliance on the absence of parallel provisions pertaining to the treatment of residential mortgages between Chapters 11 and 13 overlooks the unique framework of Chapter 11, as well as the primary purpose of [§] 1123(b)(5).

Lennington, 288 B.R. at 804. Acknowledging that the “concepts of ‘cure’ and ‘modification’ are to be regarded as separate and distinct,” the *Lennington* court noted that “[c]ourts have long recognized the right of an individual Chapter 11 debtor to reinstate a residential mortgage and cure a pre[-]petition arrearage in installment payments through their plans of reorganization[,]” and “[§] 1123(b)(5) did not abrogate a Chapter 11 debtor’s right to cure a default and reinstate a home mortgage.” *Lennington*, 288 B.R. at 805.

Finally, the *Lennington* court pointed out that Chapter 11 debtors may impair claims of their creditors, whether they be secured or unsecured, and that the only purpose for adding § 1123(b)(5) was to prevent these debtors from “‘modifying’ the mortgagee’s rights by bifurcating an undersecured residential mortgage into a secured claim and an unsecured claim, thereby stripping down the mortgage to the value of the house.” *Lennington*, 288 B.R. at 804, 806.

With respect to the legal issue presented, the court agrees with the holding in *Lennington* that the anti-modification language contained in § 1123(b)(5) does not prohibit the Debtors from curing their pre-petition arrearage owed to Chase within the terms of their Chapter 11 plan. As an initial matter, *Clay* can be distinguished on many levels. First, as pointed out in *Lennington*, the *Clay* decision addressed only the narrow issue of whether Chapter 11 debtors could cure the default of a balloon note due pre-petition and did not involve the issue of curing pre-petition arrearage through a regular monthly payment. See *Lennington*, 288 B.R. at 806. Second, the *Clay* court also expressly stated that it was bound by the prior interpretations of the district court under which it operated. See *Clay*, 204 B.R. at 791-92. Additionally, this court agrees that Chapter 11 differs from the other chapters of the Bankruptcy Code in many ways, and the failure of Congress to expressly provide for Chapter 11 debtors to cure mortgage arrearages through installment payments within their plans does not revoke that right. It seems contrary to the purpose of reorganization to allow Chapter 13 debtors the ability to cure pre-petition arrearage on residential real property

while denying Chapter 11 debtors the same privilege.⁴ To carry Chase's argument to its logical conclusion would mean that a debtor with an arrearage on a loan secured by his or her principal residence would not have the ability to propose a confirmable plan under Chapter 11 because the Bankruptcy Code affords them no express method by which to deal with that arrearage.

In its present form, the Debtors' proposed treatment of Chase's claim in the Fifth Amended Plan is an impermissible modification of Chase's rights under the Note and Deed of Trust. Section 1123(b)(5) does not allow Chapter 11 debtors to modify the *rights* of mortgage holders. The Supreme Court has defined these rights, in the context of § 1322(b)(2), as follows:

The term "rights" is nowhere defined in the Bankruptcy Code. In the absence of a controlling federal rule, we generally assume that Congress has "left the determination of property rights in the assets of a [debtor's] estate to state law," since such "property interests are created and defined by state law." Moreover, we have specifically recognized that "the justifications for application of state law are not limited to ownership interests," but "apply with equal force to security interests, including the interest of a mortgagee." The [creditor's] "rights," therefore, are reflected in the relevant mortgage instruments, which are enforceable under [state] law. They include the right to repayment of the principal in monthly installments over a fixed term at specified adjustable rates of interest, the right to retain the lien until the debt is paid off, the right to accelerate the loan upon default and to proceed against [debtors'] residence by foreclosure and public sale, and the right to bring an action to recover any deficiency remaining after foreclosure. . . . These are the rights that were "bargained for by the mortgagor and the mortgagee," and are rights protected from modification by § 1322(b)(2). This is not to say, of course, that the contractual rights of a home mortgage lender are unaffected by the mortgagor's Chapter 13 bankruptcy. The lender's power to enforce its rights—and, in

⁴ The court also points out that there are limits on the amount of secured and unsecured debts for Chapter 13, and thus, some individuals wishing to reorganize are precluded from Chapter 13 and are limited to relief under Chapter 11. See 11 U.S.C.A. § 109(e) (West 1993 & Supp. 2004).

particular, its right to foreclose on the property in the event of default—is checked by the Bankruptcy Code’s automatic stay provision.

See Nobelman v. Am. Sav. Bank, 113 S. Ct. 2106, 2110 (1993) (internal citations omitted); *see also In re Lane*, 238 B.R. 534, 537-38 (Bankr. E.D. Tenn. 2000).

At the March 30, 2004 hearing, the Debtors’ counsel acknowledged that the proposed monthly payment to Chase is an amortized figure, based upon the current claim amount owed to Chase, together with the 8.5% contractual rate of interest, and attorney’s fees. Figuring the monthly payment in this fashion serves to modify Chase’s rights under the original Note and Deed of Trust, even though the proposed payment amount would pay the full amount due Chase by the original November 1, 2006 maturity date. In order to comply with § 1123(b)(5), Chase’s claim must not be impaired. To accomplish this goal, the Debtors must make the monthly payment required by the Note, \$1,329.40, through the November 1, 2006 maturity date. They must also pay to Chase the required monthly amount for property taxes and homeowners insurance, as required by the Deed of Trust, to be held in escrow and paid by Chase under the terms of the Deed of Trust. Finally, they may then take the arrearage due Chase and, to the extent allowed by the Note, amortize that amount at 8.5% interest to be paid by November 1, 2006, as well as pay Chase’s attorney’s fees over the length of that time. On the other hand, the court does not believe that the Debtors must make two or three separate payments to Chase, as long as they can break down the final monthly payment amount as herein instructed.

III

In summary, while the court finds that 11 U.S.C.A. § 1123(b)(5) does not preclude Chapter 11 debtors from curing arrearages owed on residential real property, the Debtors' proposed treatment of Chase's claim in their Fifth Amended Plan is an impermissible modification of Chase's rights under the terms of the Note and Deed of Trust securing the Real Property. Accordingly, the Debtors will be required to further amend their Chapter 11 plan, in accordance with the instructions contained within this Memorandum.

An order consistent with this Memorandum will be entered.

FILED: April 6, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

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Debtors

ORDER

For the reasons stated in the Memorandum on Confirmation of Debtors' Fifth Amended Plan of Reorganization filed this date, the court directs the following:

1. The Objection to Fourth Amended Plan of Reorganization filed by Chase Manhattan Mortgage Corporation on December 31, 2003, is SUSTAINED. Confirmation of the Debtors' Fifth Amended Plan of Reorganization is DENIED.

2. The Debtors shall have fourteen (14) days to further amend their plan to modify their treatment of the Class 4.1 claim of Chase Manhattan Mortgage Corporation to conform to the court's findings.

3. Another confirmation hearing will be held on April 29, 2004, at 10:00 a.m., in Bankruptcy Courtroom 1-C, First Floor, Howard H. Baker, Jr. United States Courthouse, Knoxville, Tennessee, to determine whether the plan, as further amended, is confirmable. The hearing will be stricken if Chase Manhattan Mortgage Corporation is in agreement that

its treatment in the finally amended plan comports to the court's ruling. In any such event, the Debtors may submit an appropriate confirmation order approved by the United States Trustee and Chase Manhattan Mortgage Corporation.

SO ORDERED.

ENTER: April 6, 2004

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE